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In the Supreme Court

of the United States

OCTOBER TERM, 1966

No. 798

WEST LOS ANGELES INSTITUTE FOR CANCER RESEARCH, a corporation,

Petitioner,

v.

WARD MAYER, MARJORIE MAYER, R. W. MAYER, and TIMBER STRUCTURES, INC., a corporation, individually and as successors in interest to Ward Mayer Structures, Inc.,

Respondents.

BRIEF IN OPPOSITION TO A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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OPINIONS

On April 30, 1964, the district court entered its findings of fact and conclusions of law (R. 312-324) which incorporated its oral opinions of December 30, 1963 (Tr. 1110-1145) and January 9, 1964 (Tr. 1197-1201).

The opinion of the United States Court of Appeals for the Ninth Circuit is reported at 366 F.2d 220. A

petition for rehearing was denied on October 6, 1966, without opinion (R. 378).

STATEMENT OF THE CASE

The facts of this case are well stated by the United States Court of Appeals for the Ninth Circuit (366 F.2d at pp. 222-233). Briefly, the transaction, out of which this controversy grew, involved a sale in 1951 of the stock of a closely held corporation to petitioner, a tax-exempt foundation, with a contemporaneous liquidation and 5-year lease-back of the assets to a new corporation (respondent Timber Structures, Inc.) which was formed to operate the same business. 80% of the profits (before taxes) of the business were to be paid, as rent, to petitioner and 90% of the rent paid over by petitioner to respondents in payment of the purchase price of $2,500,000.00. Petitioner assumed no personal liability to pay other than from rents received. Three tax features were essential to this plan: (i) the proceeds of sale must be treated as capital gains, (ii) the rentals must be deductible to the lessee-operating company as a business expense for federal income tax purposes, and (iii) the rentals must be tax exempt in the hands of the petitioner (366 F.2d at p. 223). Both lower courts have held these three tax consequences were the ". . . keystone of the plan, without which it was wholly unfeasible and would never have been seriously considered by the selling stockholders." (ibid.)

In 1954, while the transaction was still far short

of completion, the Internal Revenue Service announced to the parties that it was disallowing these three essential tax features. This disallowance was based on Revenue Ruling 54-420 (1954-2 C.B. p. 128), in which the Commissioner took the position that the rentals would be taxable income to the purchasing foundation and the payments to the selling shareholders would not be entitled to capital gains treatment. The rationale of the ruling strongly suggested that the rental payments could not be deducted as business expense by the operating company (366 F.2d at p. 223).

Thereafter, the parties agreed that no further payments would be made and they did not renew the lease. After unsuccessful attempts by petitioner to have the ruling revoked or this transaction exempted, the parties negotiated an informal agreement of rescission. In May, 1959, petitioner repudiated this arrangement for the voluntary reconveyance of the properties.

In March, 1960, respondents filed suit for rescission in the United States District Court for the District of Oregon. Jurisdiction was predicated solely upon diversity of citizenship and requisite jurisdictional amount under 28 U.S.C. § 1332.

In this case, the court of appeals has affirmed the district court's finding that throughout the sale negotiations the selling stockholders relied upon the claimed tax consequences of the transaction not being challenged, and repeatedly stated they were not buy-

ing a controversy with the government over the validity of the promised tax advantages. As stated by the court of appeals (366 F.2d at p. 225):

> "The court credited testimony that Ward Mayer did not accept the default provisions as adequate protection against an adverse tax ruling but requested assurances that the property would be returned if the tax assumptions underlying the transaction were challenged, and that he was given such assurances by representatives of the Institute."

The district court, sitting without a jury, heard the testimony of many witnesses during six days of trial. Nearly 500 separate exhibits were admitted into evidence. The trial court's evaluation of the testimony and the documentary evidence, and its application of Oregon substantive law, has been affirmed unanimously by the Court of Appeals.

ARGUMENT

The record presents no substantial question of law which will govern the disposition of other cases, but merely a unique factual situation of interest only to the parties before the Court. There is no substantial federal question and no issue of public importance.

I

Petitioner claims that the decision below is in conflict with *Commissioner* v. *Brown*, 380 U.S. 563, because in 1965 this Court, in effect, held the 1954 revenue ruling to be erroneous as to one facet of the transaction therein involved, namely the denial of

capital gains treatment to the selling shareholders. Petitioner argues that the *Brown* decision stated the law existing in 1954. Such a contention is not realistic.

There is no question here as to the "legal effect" of a ruling issued by the Commissioner of Internal Revenue. Obviously, a revenue ruling is not law but merely ". . . an expression of the official interpretation or policy . . ." of the Commissioner ". . . intended to serve the purpose of establishing principles and policies of the Service in the interpretation and application of substantive tax law" (Rev. Rul. 54-172, C.B. 1954-1, 394, 395). In this case, the lower courts have found that in October 1954 the parties ". . . were informed by the Internal Revenue Service that the ruling [Rev. Rul. 54-420] applied to their transaction" and that ". . . this completely frustrated the carrying out of the transaction" (366 F.2d at p. 223). After explaining how the ruling frustrated the parties, the Court of Appeals summarized the "abundant evidence" that the parties themselves ". . . recognized that application of the ruling to their transaction rendered performance impossible" and they acted accordingly (ibid.).

Thus, the fact of complete frustration occurred in 1954 when the Internal Revenue Service applied the ruling to this transaction. It was then that the parties had to make their decisions. The lower courts were clearly correct in evaluating the situation of the parties as of that time, in accordance with Judge Learned Hand's view in *Borup* v. *Western Operating Corp.*, 130 F.2d 381, 386 (C.A. 2), cert. den. 317 U.S. 672:

> "The question must be answered by some test which can be applied at the time a decision must be made. That test should be whether the interruption then appears to have put an end to the voyage for all practical purposes; that is to say, that nobody with good sense would think it sound commercial judgment to keep matters in statu quo until the period of interruption might end."

Moreover, while the original format of the 1951 stock sale by respondents to petitioner was similar to the transaction described in the Court's 1965 opinion in *Commissioner* v. *Brown*, 380 U.S. 563, the similarity between the two cases ends there. In *Brown*, notwithstanding Rev. Rul. 54-420 (1954-2 C. B. 128) Brown and the institute jointly completed their sale, in part via condemnation of the properties (37 T.C. 461, 481). Brown realized $936,131.85 from rental and the sale of the properties, on which he claimed capital gain (380 U.S. at p. 568). For over five years, Brown litigated this issue with the Commissioner (37 T.C. 461, aff'd 325 F.2d 313 [C.A. 9], aff'd. 380 U.S. 563). Both this case and *Brown* were thoroughly considered by the United States Court of Appeals for the Ninth Circuit and that court, being familiar with the extensive records in both cases, found no conflict in its decisions because the facts and questions of law were indeed different.

II

The only other question upon which petitioner seeks review relates to the lower courts' application of the "unclean hands," or "*in pari delicto*" doctrine, to

respondents' suit for equitable relief. The district court found that none of respondents ". . . was guilty of inequitable conduct in any of the respects contended by defendant" (R. 322). The facts and applicable law on this subject are treated at great length by the Court of Appeals (366 F.2d at pp. 226-227).

The lower court found that "The parties were not *in pàri delicto*" (366 F.2d at p. 227) and petitioner's contentions are based in part on an erroneous reading of the findings below. The finding of fact, affirmed below, was that respondents were prevailed upon by the agents of petitioner, purporting to have an expertise which the respondents lacked and standing in a superior position, to omit a written agreement to rescind because, as petitioner's agents argued, it would be an "extraneous provision," not relevant to the legitimacy of the transaction from a tax point of view (ibid.).

Petitioner's argument that the decision of the Court of Appeals is "directly in conflict" with this Court's decision in *Precision Instr. Mfg. Co.* v. *Automotive M. Mach. Co.*, 324 U.S. 806, as well as decisions of the Third, Fourth and Fifth Circuits, is likewise predicated upon the erroneous assumption that the ". . . unclean hands maxim is not controlled by state law . . . It is a matter to be determined by the federal courts according to the rules and standards of the federal courts" (Petition p. 7).

Federal rules and standards relating to the "unclean hands" maxim would undoubtedly apply in a

federal court action where jurisdiction was founded upon federal statutes, such as the patent laws. *Precision* was such a case.

It is equally clear that where jurisdiction is founded solely upon diversity of citizenship, local law will control the substantive question whether a party should be barred from relief on account of "unclean hands," or because he was "*in pari delicto.*" This rule is implicit in *Guaranty Trust Co. of New York* v. *York*, 326 U.S. 99, reh. den. 326 U.S. 806. In *Steele* v. *General Mills, Inc.*, 329 U.S. 433, 440-441, reh. den. 329 U.S. 834, this Court specifically held that in a diversity case a federal court cannot apply the "unclean hands" doctrine differently than the state courts apply the rule.

Thus, the lower courts were correct in following the equity doctrine as to the limitations on the "unclean hands" defense enunciated by the Oregon Supreme Court in *Taylor* v. *Grant*, 204 Or. 10, 279 P.2d 479, reh. den. 204 Or. 36, 281 P.2d 704, and reviewed in an authoritative article on "*The Clean Hands Doctrine in Oregon*" (37 Ore. L. Rev. 160). As stated by the Court in *Precision Instr. Mfg. Co.* v. *Automotive M. Mach. Co.*, 324 U.S. 806, 815, the chancellor has broad discretion in the application of this maxim to the facts of a particular case. The application of familiar local law to a unique factual situation presents no question warranting review by this Court.

CONCLUSION

On the record before this Court, there is no substantial question or legal issue of public importance, but only petitioner's last desperate effort to secure a further review of a most unique and complicated mass of testimony and exhibits. All this evidence has been fully considered by two federal courts.

The petition for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit should be denied.

Respectfuly submitted,

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